

Message Text

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TAGS: EGEN PGOV PINS ET XF

SUBJ: THE ERITREAN ECONOMY --CAN IT SUPPORT INDEPENDENCE?

SUMMARY: THE EMBASSY, IN CONSULTATION WITH THE CONSULATE GENERAL, HAS ANALYZED THE ABILITY OF THE ERITREAN ECONOMY TO SUPPORT INDEPENDENCE. OUR DETAILED ANALYSIS IS CONTAINED IN ADDIS ABABA A-122 WHICH WILL BE POUCHED TO THE DEPARTMENT ON JUNE 30. AN INDEPENDENT ERITREA'S MOST SERIOUS ECONOMIC PROBLEMS WILL BE FOOD AND FOREIGN EXCHANGE. LONG ETHIOPIA'S MAJOR CEREAL DEFICIT PROVINCE, ERITREA WOULD HAVE TO IMPORT 180-280,000MT OF CEREALS ANNUALLY. DESPITE A STRONG INDUSTRIAL BASE, HIGH COST ERITREAN CONSUMER GOODS, HAVING ENJOYED THE PROTECTED ETHIOPIAN MARKET, WOULD NOT BE COMPETITIVE ON WORLD MARKETS. THIS, COMBINED WITH THE LACK OF SIGNIFICANT CASH CROPS AND NO EXTENSIVE MINERAL RESOURCES CURRENTLY AVAILABLE FOR EXPLOITATION, LEAVES ERITREA WITH LITTLE FOREIGN EXCHANGE EARNING POTENTIAL IN THE FACE OF HEAVY IMPORT REQUIREMENTS. FOREIGN AID, WHILE PROBABLY AVAILABLE TO ERITREA, IS SUBJECT TO MANY UNCERTAINTIES. ERITREAN INDEPENDENCE WOULD CAUSE ETHIOPIA FEW ECONOMIC DIFFICULTIES, UNLESS IT WOULD INVOLVE THE LOSS OF ASSAB. WITHOUT MAJOR MINERAL DISCOVERIES, AN
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INDEPENDENT ERITREA WOULD NOT BE ECONOMICALLY VIABLE.

FEDERATION WOULD BE AN ECONOMICALLY LOGICAL STEP ALTHOUGH THIS MIGHT BE POLITICALLY UNACCEPTABLE. END SUMMARY.

1. SHORT OF A COMPLETE EPMG COLLAPSE, IT IS UNLIKELY THAT ERITREA WILL OBTAIN DE JURE INDEPENDENCE. NEVERTHELESS, SPECULATION REGARDING POSSIBLE ERITREAN INDEPENDENCE CONTINUES TO GROW. BUT THIS SPECULATION HAS NOT INCLUDED THE ECONOMIC FUTURE OF AN INDEPENDENT ERITREA. THE FOLLOWING ANALYSIS EXAMINES THE BASIC ERITREAN ECONOMY AND THE IMPACT INDEPENDENCE WOULD HAVE ON IT.

2. AGRICULTURE: ERITREA'S MOST SERIOUS ECONOMIC PROBLEM WILL BE TO FEED THE PRESENT TWO MILLION ERITREANS AND THE FURTHER 500,000-1,000,000 NOW LIVING IN OTHER PARTS OF ETHIOPIA WHO WOULD WILLINGLY (OR BE FORCED TO) RETURN FOLLOWING INDEPENDENCE. LONG ETHIOPIA'S MAJOR CEREAL DEFICIT PROVINCE, ERITREA HAS TRADITIONALLY MET ITS 90-100,000MT DEFICIT FROM BEGEMDIR AND WOLLO PRODUCTION. WITH THE RETURNEES, THE DEFICIT COULD RISE TO 180-280,000MT. ERITREA DOES NOT PRODUCE SUFFICIENT CASH CROPS TO COVER THE ESTIMATED US\$30-50MILLION COST OF THESE CEREALS.

3. INDUSTRY AND MINERALS: INDUSTRY HAS BEEN THE ECONOMY'S STRONGEST SECTOR. ABOUT ONE-THIRD OF ALL ETHIOPIAN INDUSTRIAL FIRMS ARE LOCATED IN ERITREA EMPLOYING ABOUT ONE-FOURTH OF THE TOTAL ETHIOPIAN INDUSTRIAL WORK FORCE. ERITREAN INDUSTRY IS BASED ON PROVIDING CONSUMER GOODS FOR THE ETHIOPIAN MARKET, WHICH ABSORBS ABOUT 50 PERCENT OF SOME FIRMS' TOTAL PRODUCTION. MOST OF INDUSTRY'S RAW, INTERMEDIATE AND CAPITAL GOODS MUST BE IMPORTED. ERITREA HAS CONSIDERABLE MINERAL POTENTIAL. THE ONLY NEAR TERM FOREIGN EXCHANGE EARNER WILL BE THE NOW ABANDONED DEBARWA COPPER DEPOSITS WHICH COULD PRODUCE 24,000 MT ANNUALLY.

4. FOREIGN EXCHANGE: FOREIGN EXCHANGE AVAILABILITY WILL BE INDEPENDENT ERITREA'S SECOND MOST SERIOUS ECONOMIC PROBLEM. ERITREA'S INITIAL EXPORT POTENTIAL WILL DEPEND ON THE AGRICULTURAL AND INDUSTRIAL SECTORS. AS NOTED ABOVE, THE AGRICULTURAL SECTOR WILL NOT BE A MAJOR FOREIGN EXCHANGE EARNER AND SINCE ERITREA'S INDUSTRIAL SECTOR HAS FUNCTIONED

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BEHIND ETHIOPIA'S PROTECTIVE TARIFF BARRIER (WHICH HAS ENCOURAGED HIGH-COST, INEFFICIENT INDUSTRIAL GROWTH), ERITREAN INDUSTRY WILL HAVE A HARD TIME COMPETING WITH MAJOR EXPORTING NATIONS IN ETHIOPIAN AND OTHER MARKETS. GIVEN THESE POOR EXPORT PROSPECTS AND HEAVY IMPORT REQUIREMENTS, ERITREA WILL FACE A SUBSTANTIAL TRADE DEFICIT.

5. ECONOMIC ASSISTANCE: AS AN ETHIOPIAN PROVINCE, ERITREA

CURRENTLY ENJOYS NO DIRECT BENEFIT FROM THE VAST AMOUNT OF ECONOMIC ASSISTANCE PROVIDED TO ETHIOPIA. ERITREA'S MAJOR POTENTIAL WESTERN DONOR, ITALY, MAY LIMIT ITS ECONOMIC ASSISTANCE IF ITALIAN RESIDENTS AND INVESTMENT ARE NOT WELCOME IN INDEPENDENT ERITREA. ARAB ASSISTANCE WOULD NOT BE AUTOMATIC. FOR EXAMPLE, SIGNIFICANT ARAB AID MAY NOT BE AVAILABLE TO A CHRISTIAN-DOMINATED ERITREA. MOREOVER, CONSERVATIVE ARAB STATES WOULD BE RELUCTANT TO HELP A RADICAL LEFTIST REGIME. ERITREA WOULD ALSO REQUIRE GRANT MILITARY ASSISTANCE ALTHOUGH IT IS DIFFICULT TO SPECULATE AT THIS STAGE ON LIKELY POTENTIAL DONORS.

6. ECONOMIC IMPACT ON THE REST OF ETHIOPIA: WITH ERITREAN INDEPENDENCE, ETHIOPIA'S PRINCIPAL PROBLEM WOULD BE ACCESS TO THE SEA UNLESS ETHIOPIA RETAINED DIRECT ACCESS TO ASSAB. OTHER ECONOMIC PROBLEMS COULD BE OVERCOME WITH LITTLE DIFFICULTY.

7. CONCLUSION. ERITREA'S TWIN ECONOMIC PROBLEMS OF FOOD AND FOREIGN EXCHANGE HIGHLIGHT THE INCOMPATIBILITY OF DE JURE INDEPENDENCE WITH ERITREA'S NEED FOR ACCESS TO ETHIOPIAN MARKET. A POSSIBLE SOLUTION WOULD BE A COMMON MARKET PROVIDING FOR A COMMON CURRENCY AND POOLED FOREIGN EXCHANGE RESERVES ALTHOUGH THERE WOULD BE CERTAIN POLITICAL PROBLEMS ARISING FROM ALLOCATING FOREIGN EXCHANGE RESERVES BETWEEN THE PARTNERS. IN THE SHORT RUN, AN INDEPENDENT ERITREA IS NOT ECONOMICALLY VIABLE. IN THE LONGER RUN PERHAPS, BUT WITHOUT MAJOR MINERAL DISCOVERIES THE ANSWER IS STILL PROBABLY NO. WELL-EDUCATED ERITREANS EXPRESS A WILLINGNESS TO "TIGHTEN THEIR BELT" TO ACHIEVE INDEPENDENCE WITHOUT UNDERSTANDING WHAT THIS MAY INVOLVE. THEY HOPE FOR AN UNLIKELY INTERIM STEP BETWEEN PROVINCIAL AND INDEPENDENT STATUS TO EASE THE SHOCK OF TRANSITION. THEY DO NOT REALIZE THAT THERE ARE FEW POLITICAL

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INCENTIVES FOR ETHIOPIA TO FACILITATE SUCH A DEVELOPMENT. IN FACT, IN HARD ECONOMIC TERMS, ETHIOPIA WOULD PROBABLY BE BETTER OFF WITHOUT ERITREA. ECONOMICALLY, FEDERATION WOULD BE THE MOST DESIRABLE GOAL FOR ERITREA (ALTHOUGH STILL SECOND BEST TO REMAINING PART OF ETHIOPIA). HOWEVER, IT STANDS IN STARK CONTRAST TO THE POLITICAL PRESSURES FAVORING INDEPENDENCE. IN TERMS OF ERITREAN NATIONAL ASPIRATIONS, FEDERATION MAY PROVE AS UNACCEPTABLE AS MILITARY DEFEAT, YET FROM THE PERSPECTIVE OF ERITREAN ECONOMIC REALITIES, INDEPENDENCE LIKELY WOULD BE JUST SHORT OF DISASTER.

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